

the FASB issued Statement of Financial Accounting Standards No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133 - An amendment of FASB Statement No. 133" ("SFAS No. 137"). SFAS No. 137 delays the effective date of SFAS No. 133 to financial quarters and financial years beginning after June 15, 2000. The Company does not typically enter into arrangements that would fall under the scope of Statement No. 133 and thus, management believes that Statement No. 133 will not significantly affect its financial condition and results of operations.

#### Statement of Position 98-9

In December 1998, the American Institute of Certified Public Accountants issued Statement of Position 98-9 ("SOP 98-9"), "Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions." SOP 98-9 amends certain paragraphs of Statement of Position 97-2 ("SOP 97-2"), "Software Revenue Recognition," to require the application of a residual method of accounting for software revenue when certain conditions exist. SOP 98-9 also amends Statement of Position 98-4 ("SOP 98-4"), "Deferral of the Effective Date of a Provision of SOP 97-2" to extend the deferral of the application of certain passages of SOP 97-2 provided by SOP 98-4 through fiscal years beginning on or before March 15, 1999. All other provisions of SOP 98-9 are effective for transactions entered into in fiscal years beginning after March 15, 1999. Earlier adoption is permitted, however, retroactive application is prohibited. The Company believes SOP 98-9 will not materially impact its financial statements.

#### Staff Accounting Bulletin No. 101

In December 1999, the Securities and Exchange Commission staff released Staff Accounting Bulletin No. 101, "Revenue Recognition" ("SAB 101"). SAB 101 provides interpretive guidance on the recognition, presentation and disclosure of revenue in financial statements. SAB 101 must be applied to financial statements no later than the second fiscal quarter of 2000. The Company is currently reviewing SAB 101 to determine what impact, if any, the adoption of SAB 101 will have on its financial position and results of operations.

### (3) DISCONTINUED OPERATIONS

On June 30, 1997, the Company sold the net assets of its Premise Products Division. The sale resulted in a net loss of \$2,032,000. The net losses of this division are included in the statements of operations as loss from operations of discontinued division. Revenue from the division for the six months ended June 30, 1997 was \$5,785,000. Net losses from operations of this division totaled \$226,000 and \$876,000 in 1999 and 1997, respectively, and are presented in the Company's financial statements as loss from operations of discontinued division. The loss from discontinued operations in 1999 resulted from final closeout of unassigned contracts and the transition of customers to the company that acquired this division.

### (4) STOCKHOLDERS' EQUITY (DEFICIT)

#### Common Stock and Preferred Stock

In March 1998, the Company's Board of Directors authorized an increase in common stock to 30,000,000 shares and authorized 15,000,000 shares of undesignated preferred stock. In 1998 the Company also retired 36,250 shares of treasury stock.

#### Mandatorily Redeemable Convertible Preferred Stock

In connection with the Company's initial public offering in June 1998, the Company's mandatorily redeemable convertible preferred stock was converted on a one-for-one basis to common stock. Activity for 1997, 1998 and 1999 is as follows:

	Shares Issued and Outstanding						Total
	Series A	Series B	Series C	Series D	Series E	Series F	
BALANCES, at December 31, 1996 and 1997 .....	1,515,152	1,010,101	442,328	912,123	1,083,381	1,225,490	6,188,575
Conversion of preferred stock to common stock .....	(1,515,152)	(1,010,101)	(442,328)	(912,123)	(1,083,381)	(1,225,490)	(6,188,575)
BALANCES, at December 31, 1998 and 1999 .....	==	==	==	==	==	==	==

The activity related to the liquidation or redemption value of Series A through Series F Convertible Preferred Stock for the periods ended December 31, 1997, 1998 and 1999 is as follows:

	Liquidation or Redemption Value						Total
	Series A	Series B	Series C	Series D	Series E	Series F	
BALANCES, at December 31, 1996.....	\$ 1,500,000	\$ 1,000,000	\$ 730,000	\$ 2,242,000	\$ 3,044,000	\$ 5,333,000	\$ 13,849,000
Dividends accrued on Series D, E and F Convertible Preferred Stock .....	—	—	—	129,000	211,000	400,000	740,000
BALANCES, at December 31, 1997.....	1,500,000	1,000,000	730,000	2,371,000	3,255,000	5,733,000	14,589,000
Dividends accrued on Series D, E and F Convertible Preferred Stock .....	—	—	—	62,000	101,000	192,000	355,000
Conversion of Series A-F Convertible Preferred Stock to Common Stock.....	(1,500,000)	(1,000,000)	(730,000)	(2,433,000)	(3,356,000)	(5,925,000)	(14,944,000)
BALANCES, at December 31, 1998 and 1999 .....	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —

Until the mandatorily redeemable convertible preferred stock was converted, dividends of 8% per year were accrued that would be due upon liquidation or redemption.

#### Putable Common Stock Warrant

In November 1997, the Company borrowed \$4,000,000 from Banc One Capital Partners II, LLC (the "Lender") (Note 5). In connection with the loan, the Lender received a warrant to purchase 195,148 shares of the Company's common stock for \$100. In June 1998, the Lender exercised this warrant. Because of the put feature of the warrant, the Company recorded an amount equal to the number of shares under the warrant times the difference between the current market value, as defined, and the market value of the shares at the time the warrant was issued. This amount was recorded as an increase in the value of the putable common stock warrant and charged to accumulated deficit in the accompanying financial statements through the time that the warrant was exercised. The amount recorded was \$77,000 and \$8,000 in 1998 and 1997, respectively.

#### Stock Subscriptions Receivable

In September 1997, in connection with the sale of the Company's Premise Products Division, several former employees of the Company signed full recourse promissory notes to the Company to exercise their vested stock options. The notes accrue interest at 6.07% per annum. The Company extended the due date on the notes to March 20, 1999 and is pursuing collection of the note that remains unpaid.

#### Stock Option Plan

The Company adopted the 1998 Stock Incentive Plan ("1998 Plan") effective June 23, 1998, which is a successor to the Company's 1990 Option Plan. As of December 31, 1999, a total of 3,257,647 shares have been authorized for issuance under the 1998 Plan, including shares authorized under the 1990 Option Plan. The shares reserved for issuance will increase automatically on the first trading day of each calendar year, beginning with the 1999 calendar year, by 3% of the number of shares of common stock outstanding on the last trading day of the immediately preceding calendar year. The share reserve was increased by 326,590 shares under this provision in 1999. The 1998 Plan allows for issuances of options to officers, non-employee Board members and consultants, as provided for under the terms of the 1998 Plan.

#### Employee Stock Purchase Plan

On March 18, 1998, the Company adopted an employee stock purchase plan ("ESPP") under which eligible employees may contribute up to 10% of their salaries through payroll deductions to purchase shares of the Company's common stock. The first offering period of the ESPP began March 1, 1998 and ended on December 31, 1998. Thereafter, offering periods will be successive six month periods. At the end of each offering period, amounts contributed by employees will be used to purchase shares of the Company's common stock at a price equal to 85%

of the lower of the closing price of the common stock on the first day or last day of the offering period. The Company's Board of Directors has authorized the issuance of up to 200,000 shares under the ESPP and may terminate the ESPP at any time. At March 1 of each year, the shares available under the ESPP will be restored to 200,000, although the Company's Board of Directors may elect to restore a lesser number of shares. The Company issued 38,679 and 61,105 shares under the ESPP in 1999 and 1998, respectively.

#### Statement of Financial Accounting Standards No. 123 ("SFAS 123")

SFAS 123, "Accounting for Stock-Based Compensation," defines a fair value based method of accounting for employee stock options or similar equity instruments. However, SFAS 123 allows the continued measurement of compensation cost for such plans using the intrinsic value based method prescribed by APB Opinion No. 25, provided that pro forma disclosures are made of net income or loss assuming the fair value based method of SFAS 123 had been applied. The Company has elected to account for its stock-based compensation plans under APB 25; accordingly, for purposes of the pro forma disclosures presented below, the Company has computed the fair values of all options granted under the 1998 Plan, which succeeds the 1990 Option Plan, during 1999, 1998 and 1997, using the Black-Scholes pricing model and the following weighted average assumptions:

	1999	1998	1997
Risk-free interest rate.....	5.40%	4.71%	6.41%
Expected dividend yield.....	0.00%	0.00%	0.00%
Expected lives outstanding .....	4.8 years	4.4 years	5.0 years
Expected volatility.....	78.614%	66.004%	0.001%

To estimate lives of options for this valuation, it was assumed options will be exercised upon becoming fully vested. All options are initially assumed to vest. Cumulative compensation costs recognized in pro forma net income or loss with respect to options that are forfeited prior to vesting is adjusted as a reduction of pro forma compensation expense in the period of forfeiture. Because the Company's common stock was not yet publicly traded, the expected market volatility was assumed to be zero in 1997. In 1998 and 1999, the Company's common stock was not yet traded for an extended period of time, thus the expected market volatility was based on the stock prices of companies whose operations are similar to the Company's. Actual volatility of the Company's common stock may vary. Fair value computations are highly sensitive to the volatility factor assumed; the greater the volatility, the higher the computed fair value of options granted.

The total fair value of options granted under the 1998 Option Plan and the ESPP was computed to be approximately \$2,630,000, \$1,406,000 and \$499,000 for the years ended December 31, 1999, 1998 and 1997, respectively. These amounts are amortized ratably over the vesting periods of the options or recognized at date of grant if no vesting period is required. Pro forma stock-based compensation, net of the effect of forfeitures, was \$496,000, \$417,000 and \$232,000 for 1999, 1998 and 1997, respectively.

A summary of stock options under the 1998 Plan and the ESPP as of December 31, 1999, 1998 and 1997 and changes during the years then ended are presented below:

	1999		1998		1997	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year .....	1,339,880	\$ 3.62	1,106,610	\$ 3.03	1,073,908	\$ 1.68
Granted.....	740,364	5.15	379,211	5.81	270,016	6.93
Exercised .....	(179,079)	2.56	(68,494)	0.54	(153,382)	1.00
Canceled .....	(245,301)	5.43	(77,447)	8.64	(83,932)	2.46
Outstanding at end of year .....	<u>1,655,864</u>	\$ 4.15	<u>1,339,880</u>	\$ 3.62	<u>1,106,610</u>	\$ 3.03
Weighted average fair value of options granted.....	<u>\$ 3.38</u>		<u>\$ 3.19</u>		<u>\$ 1.80</u>	

The following table summarizes information about the options outstanding at December 31, 1999:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at 12/31/99	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at 12/31/99	Weighted Average Exercise Price
\$0.12 — 0.30 .....	184,509	1.19 years	\$ .18	184,509	\$ .18
\$0.75 — 3.00 .....	334,217	5.33 years	1.98	322,410	1.94
\$3.63 — 5.13 .....	679,103	9.13 years	4.39	90,292	4.09
\$6.00 — 7.50 .....	425,351	8.13 years	6.59	80,344	7.42
\$9.00 — 12.75 .....	32,684	8.30 years	11.93	16,078	12.02
	<u>1,655,864</u>	7.21 years	\$ 4.15	<u>693,633</u>	\$ 2.62

If the Company had accounted for its stock-based compensation plan in accordance with SFAS 123, the Company's net income from continuing operations would have been reported as follows:

	1999	1998	1997
Net income (loss) from continuing operations before extraordinary item:			
As reported.....	\$(1,062,000)	\$ 3,880,000	\$ 4,783,000
Pro forma .....	\$(1,373,000)	\$ 3,619,000	\$ 4,638,000
Basic net income (loss) per share from continuing operations before extraordinary item:			
As reported.....	\$ (0.10)	\$ 0.53	\$ 2.17
Pro forma .....	\$ (0.12)	\$ 0.50	\$ 2.09
Diluted net income (loss) per share from continuing operations before extraordinary item:			
As reported.....	\$ (0.10)	\$ 0.38	\$ 0.54
Pro forma .....	\$ (0.12)	\$ 0.35	\$ 0.53

## (5) LONG-TERM DEBT

At December 31, 1999 and 1998, long-term debt consisted of the following:

	December 31,	
	1999	1998
Capitalized lease obligations for equipment due on various dates through December 1, 2002, minimum monthly payments in varying amounts, currently approximately \$189,000 including imputed interest ranging from 7.75% to 9.50% per annum, collateralized by the related assets with a net book value of \$3,838,000 and \$4,273,000, respectively.....	4,009,000	4,409,000
Less — Current portion.....	(1,971,000)	(1,618,000)
	<u>\$ 2,038,000</u>	<u>\$ 2,791,000</u>

The Company prepaid its \$4,000,000 note payable to Banc One Capital Partners II, LLC on June 30, 1998 and incurred a prepayment premium equal to 4% of the amount, totaling \$160,000. In addition, the Company wrote-off the remaining debt discount related to the note payable of \$1,282,000. The prepayment penalty and write-off of the debt discount totaling \$1,442,000 were recorded as an extraordinary item, net of the related income tax benefit of \$533,000.

Debt maturities of long-term debt as of December 31, 1999, are as follows:

	Capital Leases
2000 .....	\$ 2,250,000
2001 .....	1,633,000
2002 .....	537,000
	<u>4,420,000</u>
Less — Amount related to interest .....	(411,000)
Principal portion of future obligations.....	4,009,000
Less — Current portion.....	(1,971,000)
	<u>\$ 2,038,000</u>

## (6) INCOME TAXES

The Company has operated in three countries, the United States, Canada and Australia. For income tax return reporting purposes, the Company has approximately \$11,200,000 of net operating loss carryforwards and

approximately \$723,000 of tax credit carryforwards available to offset future federal taxable income or federal tax liabilities in the United States. The research and development credit and net operating loss carryforwards expire at various dates through 2019.

The Tax Reform Act of 1986 contains provisions which may limit the net operating loss and credit carryforwards available to be used in any given year upon the occurrence of certain events including significant changes in ownership of the Company. In accordance with certain provisions of the Internal Revenue Code of 1986, as amended (the "Code"), a greater than 50% change in ownership of a company within a three-year period results in an annual limitation on the Company's ability to utilize its net operating loss carryforwards from tax periods prior to the ownership change.

Deferred income tax assets and liabilities at December 31, 1999 and 1998, were as follows:

	December 31,	
	1999	1998
Current -		
Accrued liabilities and other.....	\$ 640,000	\$ 852,000
Deferred revenue.....	70,000	200,000
Net operating loss carryforwards.....	—	1,179,000
Less - Valuation allowance.....	(57,000)	(206,000)
	<u>653,000</u>	<u>2,025,000</u>
Noncurrent -		
Depreciation differences.....	(1,057,000)	(901,000)
Net operating loss carryforwards.....	4,150,000	1,974,000
Tax credit carryforwards.....	723,000	675,000
Less - Valuation allowance.....	(393,000)	(244,000)
	<u>3,423,000</u>	<u>1,504,000</u>
	<u>\$ 4,076,000</u>	<u>\$ 3,529,000</u>

The Company recorded an income tax benefit of \$568,000 in 1999 as it believes that it is more likely than not that the net operating loss generated will be utilized against future earnings. As of December 31, 1998, the Company reversed \$1,689,000 of the valuation allowance on part of its deferred tax assets, as the Company believes it is more likely than not that such tax benefits will be realized. Approximately \$533,000 of the income tax benefit in 1998 was allocated to the extraordinary loss on early extinguishment of debt.

Management believes the remaining tax assets of \$450,000 as of December 31, 1999 relate to tax credits that do not satisfy the realization criteria set forth in SFAS No. 109 and has recorded a valuation allowance for such net tax assets.

The components of the benefit for income taxes attributable to income from operations as of December 31, 1999, 1998 and 1997, were as follows:

	December 31,		
	1999	1998	1997
Current provision — state.....	\$ —	\$ —	\$ 172,000
Deferred benefit, federal and state.....	(468,000)	(912,000)	(2,500,000)
Income tax benefit.....	<u>\$ (468,000)</u>	<u>\$ (912,000)</u>	<u>\$ (2,328,000)</u>

The components of the provision (benefit) for income taxes attributable to income from discontinued operations as of December 31, 1999, 1998 and 1997, were as follows:

	December 31,		
	1999	1998	1997
Current provision —			
Foreign.....	\$ —	\$ —	\$ 100,000
Deferred benefit —			
Federal.....	<u>\$ (100,000)</u>	<u>\$ —</u>	<u>\$ —</u>

A reconciliation of income tax benefit computed by applying the federal income tax rate of 34% to income from continuing operations before income taxes as of December 31, 1999, 1998 and 1997, is as follows:

	December 31,		
	1999	1998	1997
Computed normal tax (benefit) provision .....	\$ (631,000)	\$ 700,000	\$ 835,000
Tax effect of permanent differences and other .....	124,000	9,000	34,000
State tax, net of federal tax impact .....	(61,000)	68,000	113,000
Change in valuation allowance attributable to continuing operations .....	—	(1,689,000)	(3,310,000)
Income tax benefit .....	<u>\$ (568,000)</u>	<u>\$ (912,000)</u>	<u>\$ (2,328,000)</u>

The benefit for income taxes is attributable to continuing operations and discontinued operations in 1999, 1998 and 1997 is as follows.

	December 31,		
	1999	1998	1997
Provision (benefit) attributable to continuing operations .....	\$ (468,000)	\$ 777,000	\$ 982,000
Change in valuation allowance attributable to continuing operations ..	—	(1,689,000)	(3,310,000)
Net benefit attributable to continuing operations .....	<u>(468,000)</u>	<u>(912,000)</u>	<u>(2,328,000)</u>
Benefit attributable to discontinued operations .....	(100,000)	—	(797,000)
Change in valuation allowance attributable to discontinued operations ..	—	—	897,000
Net provision attributable to discontinued operations .....	<u>(100,000)</u>	<u>—</u>	<u>100,000</u>
Total income tax benefit .....	<u>\$ (568,000)</u>	<u>\$ (912,000)</u>	<u>\$ (2,228,000)</u>

## (7) COMMITMENTS

The Company leases its office and research facilities and certain equipment under operating lease agreements which expire through November 2003. Rent expense for the years ended December 31, 1999, 1998 and 1997 was approximately \$1,370,000, \$1,030,000 and \$718,000, respectively. Future minimum lease obligations under these agreements are as follows:

2000 .....	\$ 1,580,000
2001 .....	1,553,000
2002 .....	1,552,000
2003 .....	36,000
Total .....	<u>\$ 4,721,000</u>

## (8) EMPLOYEE BENEFIT PLAN

The Company has a 401(k) plan under which eligible employees may defer up to 15% of their compensation. The Company may make matching contributions and discretionary contributions if approved by the Board of Directors. For 1998 and 1997, no employer matching or discretionary contributions were made to the 401(k) plan. However, in February 1999, the Company's Board of Directors approved a matching contribution for employees, which was effective April 1, 1999. The Company matches 50% of employee contributions up to 6% of the employee's salary, not to exceed \$1,000 in 1999 and 2000, respectively. Matching contributions will vest 35%, 70% and 100% for one, two and three years of service, respectively.

## (9) RELATED PARTY TRANSACTION

The Company provides data management and certain consulting services to and leases equipment from entities in which a stockholder of the Company has an ownership interest. A representative of the stockholder was a member of the Company's Board of Directors until December 2, 1999. The Company received net proceeds of approximately \$6,979,000, \$6,735,000 and \$6,959,000 in 1999, 1998 and 1997, respectively, pursuant to these agreements. Amounts due to the stockholder under the capital lease agreements net of amounts due to the Company for services rendered as of December 31, 1999 and 1998 were \$3,262,000 and \$3,962,000, respectively. The leases have interest rates ranging from 7.75% to 9.50%, require monthly payments and have expiration dates varying through October 2002.

## (10) REPORTABLE SEGMENTS AND MAJOR CUSTOMERS

### Reportable Segments

The Company has two reportable segments, data management services and licenses and implementation services. The Company measures its reportable segments based on revenue for each segment and costs directly related to each segment. General and administrative, sales and marketing and other costs are not measured by segment. Data management services include the provisioning of an outsourcing solution for 9-1-1 data management to customers, including ILECs, CLECs, wireless carriers and state and local governments. Licenses and implementation services include the licensing, customization and installation of the Company's 9-1-1 software solutions. Substantially all of the Company's customers are in the United States.

These segments are managed separately because the nature of and resources used for each segment is unique. Data management services include ongoing data management and monitoring of systems and other enhanced services. Under data management services, the customer's data is transferred to the Company's systems and the Company owns the systems used to manage the data. Under licenses and implementation services, the customer performs data management and systems monitoring activities. The customer also owns the hardware, licenses the Company's software and maintains the data on its internal systems under this segment.

Revenue and costs are segregated in the Statement of Operations for the two reportable segments. The Company does not segregate assets between the segments as it is impractical to do so.

#### **Major Customers**

Revenue from certain customers exceeded 10% of total revenue for the respective year as follows: 27%, 27% and 26% in 1999; 27%, 25% and 21% in 1998 and 30%, 29% and 22% in 1997. Contracts with certain of these customers have a ten-year duration and provide for fixed monthly fees based upon the number of subscriber records managed and upon the services selected by the customer. All of these customers are in the Company's data management services segment.

#### **(11) LEGAL MATTERS**

The Company is subject to various claims and business disputes in the ordinary course of business. While the outcome of these matters cannot be predicted with certainty, management anticipates that the ultimate outcome of the issues will not have a material impact on the financial statements. Federal and state regulations governing 9-1-1 service provisioning have typically applied to local exchange services providers. The Company plans to provide 9-1-1 services directly to state and local governments rather than local exchange carriers in certain areas. Since this is the first time that such services have been provided in this manner, the regulations are being challenged and clarified for the first time. The Company believes that the services it provides are within the scope of the existing regulations and that any challenges to the regulations will be decided in the Company's favor. However, if the regulations are challenged and are not decided in the Company's favor, the Company may be prohibited from expanding its services to certain markets.

#### **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

### **PART III**

#### **ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

Information required by this item, insofar as it relates to directors and executive officers, will be contained in the definitive Proxy Statement with respect to the Company's 2000 Annual Meeting of Stockholders (the "2000 Proxy Statement"), and is hereby incorporated by reference thereto.

#### **ITEM 11. EXECUTIVE COMPENSATION**

Information required by this item will be contained in the 2000 Proxy Statement and is hereby incorporated by reference thereto.

#### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

Information required by this item will be contained in the 2000 Proxy Statement and is hereby incorporated by reference thereto.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

Information required by this item will be contained in the 2000 Proxy Statement and is hereby incorporated by reference thereto.

**PART IV**

**ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES & REPORTS ON FORM 8-K**

**(1) Financial Statements**

The financial statements filed as part of this report are listed on the index to financial statements on page 32.

**(2) Financial Statement Schedules**

All financial statement schedules have been omitted because they are not required, are not applicable or the information is included in the Financial Statements or Notes thereto.

**(3) Exhibits**

<u>Exhibit Number</u>	<u>Description</u>
3.1*	— Amended and Restated Certificate of Incorporation of the Company
3.2*	— Restated Bylaws of the Company to be effective upon the closing of the offering.
4.1*	— Form of Certificate for Common Stock.
4.2*	— Reference is made to Exhibits 3.1 and 3.2.
10.1*	— Fourth Amended and Restated Registration Rights Agreement, dated March 5, 1996.
10.2*	— 1990 Stock Option Plan.
10.3*	— 1998 Stock Incentive Plan.
10.4*	— 1998 Employee Stock Purchase Plan, as amended.
10.5*	— Form of Directors' and Officers' Indemnification Agreement.
10.6*†	— 9-1-1 Services Agreement between Ameritech Information Systems, Inc. and SCC Communications Corp., signed August 31, 1994.
10.7*†	— Agreement for Services between SCC Communications Corp. and U S West Communications, Inc. dated December 28, 1995.
10.8*†	— Services Agreement No. PR-9026-L between SCC Communications Corp. and BellSouth Telecommunications, Inc. dated October 13, 1995.
10.9*†	— Wireless E9-1-1 Agreement between SCC Communications Corp. and Ameritech Mobile Communications, Inc. dated April 1998
10.10*†	— Asset Purchase Agreement between SCC Communications Corp. and Printrak International, Inc., dated July 18, 1997.
10.11*	— Amendment One to Asset Purchase Agreement between SCC Communications Corp. and Printrak International, Inc.
10.12*	— Bank One Loan Agreement dated April 15, 1997, effective as of July 1, 1996.
10.13*	— Banc One Capital Partners and SCC Communications Corp. Senior Subordinated Note and Warrant Purchase Agreement, dated November 20, 1997.
10.14*	— Banc One Senior Subordinated Note due November 30, 2003.
10.15*	— Banc One Warrant Certificate.
10.16*	— Banc One and SCC Communications Corp. Option Agreement, dated November 20, 1997.
10.17*	— Banc One and SCC Communications Corp. Registration Rights Agreement, dated November 20, 1997.
10.18*	— Co-Sale Agreement, dated November 20, 1997, between SCC Communications Corp., George Heinrichs, John Sims, Nancy Hamilton, The Hill Partnership III, Ameritech Development Corporation, Boston Capital Ventures Limited Partnership and Banc One Capital Partners.
10.19*	— Preemptive Rights Agreement between Banc One Capital Partners and SCC Communications Corp.
10.20*	— Master Lease Agreement Between Ameritech Credit Corporation and SCC Communications Corp., dated March 11, 1996.
10.21*†	— Consulting Agreement Between SCC Communications Corp. and Ameritech Mobile Communications, Inc. dated October 27, 1997.
10.22*	— Bank One Loan Change in Terms Agreement effective as of April 15, 1998.
10.23#	— Employment Agreement between Nancy Hamilton and SCC Communications Corp.
23.1	— Consent of Arthur Andersen LLP, Independent Public Accountants.
27.1	— Financial Data Schedule.

\* Incorporated by reference to identically numbered exhibits included in the Registrant's Registration Statement on Form S-1 (File No. 333-49767), as amended.

† Confidential treatment has been requested for a portion of these Exhibits.

# Incorporated by reference to identically numbered exhibits included in the Registrant's 1998 Form 10-K.

#### (4) Reports on Form 8-K

None.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, therunto duly authorized, as of March 29, 2000.

SCC COMMUNICATIONS CORP.

By: /s/ Carol Nelson  
Carol Nelson  
Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below as of March 29, 2000 by the following persons on behalf of the registrant and in the capacities indicated.

<u>Signature</u>	<u>Title</u>
<u>/s/ George K. Heinrichs</u> <b>George K. Heinrichs</b>	President, Chief Executive Officer and Director (Principal Executive Officer)
<u>/s/ Carol Nelson</u> <b>Carol Nelson</b>	Chief Financial Officer (Principal Financial and Accounting Officer)
<u>/s/ Stephen O. James</u> <b>Stephen O. James</b>	Director
<u>/s/ Darrell A. Williams</u> <b>Darrell A. Williams</b>	Director
<u>/s/ David Kronfeld</u> <b>David Kronfeld</b>	Director
<u>/s/ Mary Beth Vitale</u> <b>Mary Beth Vitale</b>	Director
<u>/s/ Winston J. Wade</u> <b>Winston J. Wade</b>	Director

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2000

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
FOR THE TRANSITION PERIOD FROM        TO        .

COMMISSION FILE NUMBER: 000-29678

SCC COMMUNICATIONS CORP.  
(Exact Name of Registrant as Specified in Its Charter)

DELAWARE  
(State or Other Jurisdiction of  
Incorporation or Organization)

84-0796285  
(I.R.S. Employer  
Identification Number)

6285 LOOKOUT ROAD  
BOULDER, COLORADO  
(Address of Principal Executive Offices)

80301  
(Zip Code)

Registrant's Telephone Number, Including Area Code: (303) 581-5600

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒  
No ☐

As of July 31, 2000, there were 11,271,237 shares of the Registrant's Common Stock outstanding.

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**SCC COMMUNICATIONS CORP.**

**BALANCE SHEETS**  
(dollars in thousands)

	June 30, 2000	December 31, 1999
	(Unaudited)	
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents.....	\$ 9,444	\$ 8,354
Short-term investments.....	7,958	12,165
Accounts receivable, net of allowance for doubtful accounts of approximately \$58 in 2000 and 1999.....	4,254	2,255
Unbilled revenue.....	1,439	846
Prepays and other.....	1,589	548
Deferred income taxes — current portion.....	653	653
Total current assets.....	<u>25,337</u>	<u>24,821</u>
<b>PROPERTY AND EQUIPMENT, at cost:</b>		
Computer hardware and equipment.....	27,127	25,411
Furniture and fixtures.....	1,039	933
Leasehold improvements.....	958	915
	<u>29,124</u>	<u>27,259</u>
Less — Accumulated depreciation.....	<u>(18,157)</u>	<u>(15,753)</u>
Total property and equipment.....	<u>10,967</u>	<u>11,506</u>
OTHER ASSETS.....	62	86
LONG-TERM INVESTMENTS.....	995	993
DEFERRED INCOME TAXES — NONCURRENT.....	3,423	3,423
SOFTWARE DEVELOPMENT COSTS, net of accumulated amortization of \$717 and \$575 in 2000 and 1999, respectively....	1,028	951
	<u>\$ 41,812</u>	<u>\$ 41,780</u>

The accompanying notes to financial statements are an integral part of these balance sheets.

**SCC COMMUNICATIONS CORP.**

**BALANCE SHEETS**  
(dollars in thousands)

	June 30, 2000	December 31, 1999
	(Unaudited)	
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable.....	\$ 1,215	\$ 752
Payroll-related accruals.....	904	786
Other accrued liabilities.....	1,582	1,641
Property and other tax liabilities.....	874	792
Current portion of capital lease obligations.....	2,242	1,971
Deferred contract revenue.....	1,546	865
Total current liabilities.....	<u>8,363</u>	<u>6,807</u>
<b>LONG-TERM DEBT:</b>		
Capital lease obligations, net of current portion.....	1,876	2,038
Total liabilities.....	<u>10,239</u>	<u>8,845</u>
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock, \$.001 par value; 15,000,000 shares authorized; none issued or outstanding.....	—	—
Common stock, \$.001 par value; 30,000,000 shares authorized; 11,250,921 and 11,104,111 shares issued in 2000 and 1999, respectively.....	11	11
Additional paid-in capital.....	44,347	43,925
Common stock warrants.....	373	—
Stock subscriptions receivable.....	(33)	(33)
Accumulated deficit.....	<u>(13,125)</u>	<u>(10,968)</u>
Total stockholders' equity.....	<u>31,573</u>	<u>32,935</u>
	<u>\$ 41,812</u>	<u>\$ 41,780</u>

The accompanying notes to financial statements are an integral part of these balance sheets.

**SCC COMMUNICATIONS CORP.**

**STATEMENTS OF OPERATIONS**  
(dollars in thousands, except share data)  
**Unaudited**

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2000</u>	<u>1999</u>	<u>2000</u>	<u>1999</u>
REVENUE:				
ILEC Business Unit .....	\$ 7,111	\$ 6,806	\$ 13,769	\$ 13,370
CLEC Business Unit .....	1,710	891	3,409	1,489
Wireless Business Unit .....	1,034	392	1,715	846
Direct Business Unit .....	701	100	988	100
Total revenue .....	<u>10,556</u>	<u>8,189</u>	<u>19,881</u>	<u>15,805</u>
COSTS AND EXPENSES:				
ILEC Business Unit .....	3,964	3,768	7,841	7,373
CLEC Business Unit .....	538	472	1,097	880
Wireless Business Unit .....	1,186	1,148	2,235	2,084
Direct Business Unit .....	1,587	402	2,529	762
Sales and marketing .....	2,105	1,421	3,457	2,701
General and administrative .....	1,956	1,158	3,499	2,361
Research and development .....	1,177	433	1,806	848
Total costs and expenses .....	<u>12,513</u>	<u>8,802</u>	<u>22,464</u>	<u>17,009</u>
LOSS FROM OPERATIONS .....	<u>(1,957)</u>	<u>(613)</u>	<u>(2,583)</u>	<u>(1,204)</u>
OTHER INCOME (EXPENSE):				
Interest and other income .....	315	262	618	535
Interest and other expense .....	<u>(100)</u>	<u>(146)</u>	<u>(192)</u>	<u>(261)</u>
LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	<u>(1,742)</u>	<u>(497)</u>	<u>(2,157)</u>	<u>(930)</u>
INCOME TAX BENEFIT .....	<u>—</u>	<u>178</u>	<u>—</u>	<u>354</u>
LOSS FROM CONTINUING OPERATIONS .....	<u>—</u>	<u>(319)</u>	<u>—</u>	<u>(576)</u>
LOSS FROM OPERATIONS OF DISCONTINUED DIVISION, net of tax	<u>—</u>	<u>(15)</u>	<u>—</u>	<u>(124)</u>
NET LOSS .....	<u>\$ (1,742)</u>	<u>\$ (334)</u>	<u>\$ (2,157)</u>	<u>\$ (700)</u>
NET LOSS PER SHARE (Note 2):				
Basic and diluted .....	<u>\$ (0.16)</u>	<u>\$ (0.03)</u>	<u>\$ (0.19)</u>	<u>\$ (0.06)</u>
SHARES USED IN COMPUTING NET LOSS PER SHARE (Note 2):				
Basic and diluted .....	<u>11,202,361</u>	<u>10,951,832</u>	<u>11,176,482</u>	<u>10,921,227</u>

The accompanying notes to financial statements are an integral part of these statements.

**SCC COMMUNICATIONS CORP.**

**STATEMENTS OF CASH FLOWS**  
(dollars in thousands)  
**Unaudited**

	<b>Six Months Ended June 30,</b>	
	<b>2000</b>	<b>1999</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss.....	\$ (2,157)	\$ (700)
Adjustments to reconcile net loss to net cash provided by		
Operating activities —		
Amortization and depreciation.....	2,562	2,516
Accretion of and interest accrued on investments.....	(151)	(177)
Loss on disposal of assets.....	6	36
Deferred income tax benefit.....	—	(430)
Provision for doubtful accounts.....	—	50
Change in —		
Accounts receivable.....	(1,999)	1,910
Unbilled revenue.....	(593)	(11)
Prepays and other.....	(644)	(322)
Accounts payable.....	463	(252)
Accrued liabilities.....	141	(612)
Deferred contract revenue.....	681	(1,114)
Net cash provided by (used in) operating activities.....	<u>(1,691)</u>	<u>894</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Acquisition of property and equipment.....	(1,875)	(1,141)
Purchase of investments.....	(5,894)	(5,261)
Sale of investments.....	10,250	—
Software development costs.....	(220)	(328)
Net cash provided by (used in) investing activities.....	<u>2,261</u>	<u>(6,730)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Principal payments on capital lease obligations.....	(1,021)	(956)
Proceeds from equipment lease.....	1,119	—
Exercise of stock options.....	350	255
Proceeds received from employee stock purchase plan.....	72	88
Payments received from stock subscriptions.....	—	22
Net cash provided by (used in) financing activities.....	<u>520</u>	<u>(591)</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b> .....	<u>1,090</u>	<u>(6,427)</u>
<b>CASH AND CASH EQUIVALENTS, beginning of period</b> .....	<u>8,354</u>	<u>10,266</u>
<b>CASH AND CASH EQUIVALENTS, end of period</b> .....	<u><u>\$ 9,444</u></u>	<u><u>\$ 3,839</u></u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid during the period for interest.....	\$ 149	\$ 228
Cash paid during the period for taxes.....	<u>\$ 160</u>	<u>\$ 211</u>
<b>SUPPLEMENTAL SCHEDULE OF NONCASH FINANCING AND INVESTING</b>		
<b>ACTIVITIES:</b>		
Property acquired with capital leases.....	\$ 11	\$ 856
Issuance of stock warrants.....	<u>\$ 373</u>	<u>\$ —</u>

The accompanying notes to financial statements are an integral part of these statements.

## NOTES TO FINANCIAL STATEMENTS

### NOTE 1 – BASIS OF PRESENTATION

The unaudited financial statements included herein reflect all adjustments, consisting only of normal recurring adjustments, which in the opinion of management are necessary to fairly present the Company's financial position, results of operations and cash flows for the periods presented. Certain information and footnote disclosures normally included in audited financial information prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the Securities and Exchange Commission's rules and regulations. The results of operations for the period ended June 30, 2000 are not necessarily indicative of the results to be expected for any subsequent quarter or for the entire fiscal year ending December 31, 2000. These financial statements should be read in conjunction with the financial statements and notes thereto for the year ended December 31, 1999, which are included in the Company's Annual Report on Form 10-K.

### NOTE 2 – EARNINGS PER SHARE

"Basic income (loss) per share" is determined by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding during each period. "Diluted income (loss) per share" includes the effects of potentially issuable common stock, but only if dilutive (i.e., a loss per share is never reduced). The treasury stock method, using the average price of the Company's common stock for the period, is applied to determine dilution from options and warrants. The if-converted method is used for convertible securities. Potentially dilutive common stock options and warrants that were excluded from the calculation of diluted income per share because their effect is antidilutive totaled 861,213 and 1,072,924 for the three months ended June 30, 2000 and 1999, respectively, and 824,380 and 1,132,317 for the six months ended June 30, 2000 and 1999, respectively.

### NOTE 3 – WARRANTS

During the second quarter, the Company issued a warrant to purchase 100,000 shares of the Company's common stock to an investor relations consulting firm for services to be provided over one year. The Company recorded the fair value of the warrant, totaling \$273,000, as a prepaid expense which will be amortized over the one-year service period on a straight-line basis.

The Company also issued a warrant to purchase 36,590 shares of the Company's common stock to a marketing firm for services to be provided in the future. The Company recorded the fair value of the warrant, totaling \$100,000, as a prepaid expense which will be expensed as services are provided.

### NOTE 4– REPORTABLE SEGMENTS

The Company has five reportable segments, or "business units": Incumbent Local Exchange Carrier ("ILEC"), Competitive Local Exchange Carrier ("CLEC"), Wireless, Direct, and Corporate. The Company measures its reportable business units based on revenue and costs directly related to each business unit. Substantially all of the Company's customers are in the United States. The Company's business units are segmented based on the type of customer each business unit serves. The ILEC, CLEC and Wireless business units address ILEC, CLEC and wireless carriers, respectively. The Direct business unit addresses sales, either directly or indirectly, to state and local government entities. The Corporate business unit captures costs that are not directly related to a specific Business Unit. These segments are managed separately because the nature of and resources used for each segment is unique.

Revenue and costs are segregated in the Statement of Operations for the reportable segments. The Company does not segregate assets between the segments as it is impractical to do so.

For the Three Months Ending June 30:

(dollars in thousands)	ILEC		CLEC		WIRELESS		DIRECT		CORPORATE		TOTAL	
	2000	1999	2000	1999	2000	1999	2000	1999	2000	1999	2000	1999
Revenue	\$ 7,111	\$ 6,806	\$ 1,710	\$ 891	\$ 1,034	\$ 392	\$ 701	\$ 100	\$ —	\$ —	\$ 10,556	\$ 8,189
Direct costs	3,964	3,768	538	472	1,186	1,148	1,587	402	—	—	7,275	5,790
Sales and marketing	400	399	184	88	191	133	369	106	961	695	2,105	1,421
General and administrative	—	—	—	—	—	—	—	—	1,956	1,158	1,956	1,158
Research and development	43	88	77	28	225	84	208	233	624	—	1,177	433
Total	4,407	4,255	799	588	1,602	1,365	2,164	741	3,541	1,853	12,513	8,802
Operating income (loss)	2,704	2,551	911	303	(568)	(973)	(1,463)	(641)	(3,541)	(1,853)	(1,957)	(613)
Other income, net	—	—	—	—	—	—	—	—	215	116	215	116
Income (loss) before income taxes	2,704	2,551	911	303	(568)	(973)	(1,463)	(641)	(3,326)	(1,737)	(1,742)	(497)
Income tax benefit	—	—	—	—	—	—	—	—	—	178	—	178
Net income (loss) from continuing operations before extraordinary item	2,704	2,551	911	303	(568)	(973)	(1,463)	(641)	(3,326)	(1,559)	(1,742)	(319)
Loss from operations of discontinued division, net of tax	—	—	—	—	—	—	—	—	—	(15)	—	(15)
Net income (loss)	\$ 2,704	\$ 2,551	\$ 911	\$ 303	(\$ 568)	(\$ 973)	(\$ 1,463)	(\$ 641)	(\$ 3,326)	(\$ 1,574)	(\$ 1,742)	(\$ 334)

For the Six Months Ending June 30:

(dollars in thousands)	ILEC		CLEC		WIRELESS		DIRECT		CORPORATE		TOTAL	
	2000	1999	2000	1999	2000	1999	2000	1999	2000	1999	2000	1999
Revenue	\$ 13,769	\$ 13,370	\$ 3,409	\$ 1,489	\$ 1,715	\$ 846	\$ 988	\$ 100	\$ —	\$ —	\$ 19,881	\$ 15,805
Direct costs	7,841	7,373	1,097	880	2,235	2,084	2,529	762	—	—	13,702	11,099
Sales and marketing	752	863	306	194	299	284	682	156	1,418	1,204	3,457	2,701
General and administrative	—	—	—	—	—	—	—	—	3,499	2,361	3,499	2,361
Research and development	164	181	161	58	365	123	394	486	722	—	1,806	848
Total	8,757	8,417	1,564	1,132	2,899	2,491	3,605	1,404	5,639	3,565	22,464	17,009
Operating income (loss)	5,012	4,953	1,845	357	(1,184)	(1,645)	(2,617)	(1,304)	(5,639)	(3,565)	(2,583)	(1,204)
Other income, net	—	—	—	—	—	—	—	—	426	274	426	274
Income (loss) before income taxes	5,012	4,953	1,845	357	(1,184)	(1,645)	(2,617)	(1,304)	(5,213)	(3,291)	(2,157)	(930)
Income tax benefit	—	—	—	—	—	—	—	—	—	354	—	354
Net income (loss) from continuing operations before extraordinary item	5,012	4,953	1,845	357	(1,184)	(1,645)	(2,617)	(1,304)	(5,213)	(2,937)	(2,157)	(576)
Loss from operations of discontinued division, net of tax	—	—	—	—	—	—	—	—	—	(124)	—	(124)
Net income (loss)	\$ 5,012	\$ 4,953	\$ 1,845	\$ 357	(\$ 1,184)	(\$ 1,645)	(\$ 2,617)	(\$ 1,304)	(\$ 5,213)	(\$ 3,061)	(\$ 2,157)	(\$ 700)

Information for 1999 has been reclassified to reflect the realignment of various business units. Licenses and implementation services are now included in the ILEC Business Unit. ILEC, CLEC, Wireless and Direct were formerly included in Data Management Services.

#### NOTE 4 – RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

##### Statement of Financial Accounting Standards No. 133 and No. 137

In June 1998, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS 133 establishes accounting and reporting standards for derivative financial instruments and hedging activities related to those instruments as well as other hedging activities. It requires an entity to recognize all derivatives as either assets or liabilities in the statement of financial position and measures those instruments at fair value. In June 1999, the FASB issued Statement of Financial Accounting Standards No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133 - An amendment of FASB Statement No. 133." SFAS No. 137 delays the effective date of SFAS No. 133 to financial quarters and financial years beginning after June 15, 2000. The Company does not typically enter into arrangements that would fall under the scope of Statement No. 133 and thus, management believes that Statement No. 133 will not significantly affect the Company's financial condition and results of operations.

##### Staff Accounting Bulletin No. 101

In December 1999, the Securities and Exchange Commission staff released Staff Accounting Bulletin No. 101, "Revenue Recognition." SAB 101 provides interpretive guidance on the recognition, presentation and disclosure of revenue in financial statements. The accounting impact of SAB 101 is required to be determined no later than the Company's fourth fiscal quarter of 2000. If the Company determines that its revenue recognition policies must change to be in compliance with SAB 101, the implementation of SAB 101 will require the Company to restate all of its previously reported 2000 quarterly results to reflect a cumulative effect of change in accounting principle as if SAB 101 had been implemented on January 1, 2000. The Company is currently reviewing SAB 101 to determine what impact, if any, the adoption of SAB 101 will have on its financial position and results of operations.

##### FASB Interpretation No. 44

In March 2000, the Financial Accounting Standards Board issued FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation" ("FIN No. 44"). FIN No. 44 clarifies the application of APB No. 25 for certain issues related to equity-based instruments issued to employees. FIN No. 44 is effective on July 1, 2000, except for certain transactions, and will be applied on a prospective basis. Management believes that FIN No. 44 will not have a significant impact on the Company's results of operations and financial position.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

THIS QUARTERLY REPORT ON FORM 10-Q CONTAINS FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS AND UNCERTAINTIES. OUR ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THE RESULTS DISCUSSED IN THE FORWARD-LOOKING STATEMENTS. FACTORS THAT MIGHT CAUSE SUCH A DIFFERENCE INCLUDE, BUT ARE NOT LIMITED TO, THOSE DISCUSSED UNDER "ITEM 2A. FACTORS THAT MAY AFFECT FUTURE RESULTS" BELOW.

### Overview

We are the leading provider of 9-1-1 data management services to ILECs, CLECs and wireless carriers in the United States. We manage the data that enables a 9-1-1 call to be routed to the appropriate public safety agency with accurate and timely information about the caller's identification and location. We were incorporated in July 1979 in the State of Colorado under the name Systems Concepts of Colorado, Inc. and were reincorporated in September 1993 in the State of Delaware under the name SCC Communications Corp. Prior to 1995, substantially all of our revenue was derived from the sale of software licenses and related implementation services to ILECs and public safety agencies. During 1994, we began investing in infrastructure to provide our 9-1-1 OSS solution to telephone operating companies seeking to outsource such operations. We signed our first 9-1-1 data management services contract in August 1994 and continue to add to the number of records under management. We began to recognize revenue from wireless carriers in the third quarter of 1997, and continue to increase the number of live wireless subscribers managed. In addition, we signed a contract with the General Services Commission of the State of Texas in November 1998, representing the first time that a state agency has endeavored to centralize 9-1-1 OSS and data management services with a neutral third party.

Each of our Business Units provides an outsourcing solution for its respective customer bases' 9-1-1 data management. Revenue generally includes a non-recurring initial fee for the design and implementation of the solution, conversion of the customer's data to our systems, hiring and training of personnel, and other costs required to prepare for the processing of customer data. Non-recurring fees are recognized on the percentage-of-completion method over the period required to perform the tasks necessary to prepare for the processing of customer data. Our contracts also separately allow for a monthly service fee based on the number of subscriber records under management, which is recognized in the period in which the services are rendered. Related costs are expensed as they are incurred. We may also offer our customers enhanced products or services, for which revenue is recognized in the period that the work is performed. Our revenue breaks down as a percent of total revenue as follows:

	<u>Three Months</u>		<u>Six Months</u>	
	<u>Ended June 30,</u>		<u>Ended June 30,</u>	
	<u>2000</u>	<u>1999</u>	<u>2000</u>	<u>1999</u>
ILEC Business Unit	67%	83%	69%	85%
CLEC Business Unit	16%	11%	17%	9%
Wireless Business Unit	10%	5%	9%	5%
Direct Business Unit	7%	1%	5%	1%

During the six months ended June 30, 2000 and 1999, we recognized approximately 69% and 82%, respectively, of total revenue from Ameritech, BellSouth Inc. and U S WEST, each of which accounted for greater than 10% of our total revenue in such periods.

As of December 31, 1999, we had net operating loss carryforwards of \$11.2 million available to offset future net income for U.S. federal income tax purposes. Since we expect to incur losses in the near term related to development costs for new commercial products, future taxable income may not be sufficient to realize additional deferred tax assets that will be created by the projected net operating losses. Consequently, we presently expect our statement of operations will not reflect tax benefits for projected operating losses to be incurred during 2000.

In June 1997, we sold the net assets of our Premise Products Division. The sale of our Premise Products Division resulted in a net loss from the sale of \$2.0 million. Net loss from operations of this division, net of tax, totaled \$124,000 in the first six months of 1999, and is presented in our financial statements as loss from operations of discontinued division. This loss resulted from final closeout of unassigned contracts and the transition of customers to the company that acquired this division.

Historically, substantially all of our revenue has been generated from sales to customers in the United States. However, we have generated revenue in Canada and intend to enter additional international markets, which may require significant management attention and financial resources. International sales are subject to a variety of risks. See "Item 2A. Factors That May Affect Future Results."

Our quarterly and annual operating results have varied significantly in the past. The variation in operating results will likely continue and may intensify. We believe that period to period comparisons of results of operations are not necessarily meaningful and should not be relied upon as indications of future performance. Our operating results may continue to fluctuate as a result of many factors, including the length of the sales cycles for new or existing customers, the size, timing or duration of significant customer contracts, fluctuations in number of subscriber records under management, timing or duration of service offerings, rate of adoption of wireless services by Public Safety Answering Points, efforts expended to accelerate the introduction of certain new products, our ability to hire, train and retain qualified personnel, increased competition, changes in operating expenses, changes in our strategy, the financial performance of our customers, changes in telecommunications legislation and regulations that may affect the competitive environment for our services, and general economic factors. Our contracts for 9-1-1 data management services generally include a separate non-recurring fee for the design and implementation of services, conversion of the customer's data to our systems, hiring and training of personnel, and other costs required to prepare for the processing of customer data, and therefore, we may recognize significantly increased revenue for a short period of time upon commencing services for a new customer.

Our expense levels are based in significant part on our expectations regarding future revenue. Our revenue is difficult to forecast because the market for our services is evolving rapidly and the length of our sales cycle, the size and timing of significant customer contracts and license fees and the timing of recognition of non-recurring initial fees vary substantially among customers. Accordingly, we may be unable to adjust spending in a timely manner to compensate for any unexpected shortfall in revenue. Any significant shortfall could therefore have a material adverse effect on our business, financial condition and results of operations. We expect to incur expenses of approximately \$10 million in 2000 for research, development and marketing to expand our product offerings. As of June 30, 2000 we have invested approximately \$1.3 million. In addition, we hired additional employees in 1999 and year-to-date 2000, and expect to continue hiring additional employees during the remainder of 2000. We also began leasing office space in Texas in December 1999, from which we will perform some of our operations. We cannot assure you that we can report operating profits or that our investments in research and development will generate future revenue. Failure to do so could have a material adverse effect on our business, financial condition and results of operations.

We are currently reviewing the potential impact of adopting Staff Accounting Bulletin No. 101, "Revenue Recognition." SAB 101 provides interpretive guidance on the recognition, presentation and disclosure of revenue in our financial statements. We are required to determine the potential impact of SAB 101 no later than fourth quarter of 2000. If we determine that our revenue recognition policies will need to be changed to be in compliance with SAB 101, we will be required to restate all of our previously reported 2000 quarterly results to reflect the cumulative change in accounting principle as if SAB 101 had been implemented on January 1, 2000. See "Recently Issued Accounting Pronouncements."

### **Three Months Ended June 30, 2000 Compared to Three Months Ended June 30, 1999**

#### *Total Company*

Total revenue increased 29%, from \$8.2 million in the second quarter of 1999 to \$10.6 million in the second quarter of 2000. Total direct costs increased 26%, from \$5.8 million in the second quarter of 1999 to \$7.3 million in the second quarter of 2000, representing 70% and 69% of total revenue, respectively.

#### *ILEC Business Unit*

ILEC revenue increased 4%, from \$6.8 million in the second quarter of 1999 to \$7.1 million in the second quarter of 2000. ILEC subscribers under management grew to 84.4 million, an increase of 6% from June 30, 1999. The recurring portion of ILEC revenue increased 3% from the second quarter of 1999 to the same period in 2000. ILEC revenue increased due to an increase in the number of records under management and non-recurring fees recognized for enhanced services. ILEC direct costs increased 5%, from \$3.8 million in the second quarter of 1999 to \$4.0 million in the second quarter of 2000, representing 55% and 56% of ILEC revenue for such periods, respectively. Costs increased due to the hiring of additional systems operations staff and increased systems maintenance costs to accommodate growth. ILEC sales and marketing expenses of \$399,000 in the second quarter of 1999 are comparable to the sales and marketing expenses of \$400,000 in the second quarter of 2000, representing 6% of ILEC revenue for both periods. ILEC research and development costs decreased 51%, from \$88,000 in the second quarter of 1999 to

\$43,000 in the second quarter of 2000, representing 1% of ILEC revenue for both periods. ILEC research and development costs decreased due to increased focus by the Company's software engineering staff on projects for other business units.

#### *CLEC Business Unit*

CLEC revenue increased 92%, from \$891,000 in the second quarter of 1999 to \$1.7 million in the second quarter of 2000. CLEC revenue increased due to an increase in the number of records under management for new and existing customers and additional non-recurring revenue recognized on new customers signed in 2000. We now have 32 CLEC contracts, representing 4.1 million subscribers. Approximately 87% of CLEC revenue in the second quarter of 2000 was recurring.

CLEC direct costs increased 14%, from \$472,000 in the second quarter of 1999 to \$538,000 in the second quarter of 2000, representing 53% and 31% of CLEC revenue for such periods, respectively. The dollar increase in CLEC costs is due to the hiring of additional CLEC operations staff to assist with the continued growth in records under management. The percent decrease in CLEC costs is due mainly to volume efficiencies gained by the growth in records managed. CLEC sales and marketing expenses increased 109%, from \$88,000 in the second quarter of 1999 to \$184,000 in the second quarter of 2000, representing 10% and 11% of CLEC revenue for such periods, respectively. The dollar increase in CLEC sales and marketing expenses is due to the hiring of additional sales and marketing personnel to accommodate the growth in the CLEC Business Unit and increased direct marketing campaign costs. CLEC research and development costs increased 175%, from \$28,000 in the second quarter of 1999 to \$77,000 in the second quarter of 2000, representing 3% and 5% of CLEC revenue for such periods, respectively. CLEC research and development costs increased due to the development of Local Number Portability (LNP) software applications.

#### *Wireless Business Unit*

Wireless revenue increased 164%, from \$392,000 in the second quarter of 1999 to \$1.0 million in the second quarter of 2000. Wireless revenue increased due to one-time fees related to system capacity expansion to accommodate wireless carriers and an increase in the number of records under management. Wireless subscribers grew 94% from the first quarter of 2000 to 1.6 million. Public safety agency requests for wireless services increased 8% from the first quarter of 2000 to 3,530, covering approximately 18.3 million subscribers. We signed 3 new wireless contracts in the second quarter of 2000, bringing our total customers to 15. Our wireless customers represent approximately 33.3 million subscribers. Approximately 39% of wireless revenue in the second quarter of 2000 was non-recurring due to heavy implementation activity.

Wireless costs increased 3%, from \$1.1 million in the second quarter of 1999 to \$1.2 million in the second quarter of 2000, representing 293% and 115% of Wireless revenue for such periods, respectively. Costs increased due to the hiring of additional systems operations staff and increased systems maintenance and telephone line costs to accommodate growth. Wireless direct cost as a percentage of Wireless revenue decreased as the increase in subscribers managed grows to cover more of the infrastructure costs. Wireless sales and marketing expenses increased 44%, from \$133,000 in the second quarter of 1999 to \$191,000 in the second quarter of 2000, representing 34% and 18% of Wireless revenue for such periods, respectively. The increase in Wireless sales and marketing expenses is due to the hiring of additional sales personnel in 2000. Wireless research and development costs increased 168% from \$84,000 in the second quarter of 1999 to \$225,000 in the second quarter of 2000, representing 21% and 22% of Wireless revenue for such periods, respectively. Wireless research and development costs increased due to the development of improvements to our general wireless database application in 2000.

#### *Direct Business Unit*

Direct revenue increased from \$100,000 in the second quarter of 1999 to \$701,000 in the second quarter of 2000. Direct revenue increased due to the transition of records in the State of Texas, fees recognized for enhanced services and recurring and non-recurring revenues related to our Emergency Warning and Evacuation (EWE) product. Both the Texas contract and EWE were launched in the beginning of 2000. The subscriber base in Texas increased to 5.0 million and EWE increased to 500,000. We now have five EWE customers. Based on results to date, we believe we may have as many as 6.0 million records live in Texas by the end of 2000. Direct costs increased from \$402,000 in the second quarter of 1999 to \$1.6 million in the second quarter of 2000. Costs increased due to the additional personnel and system infrastructure needed to implement the State of Texas contract and to manage records that have been transitioned. In addition, we opened an office in Texas in late 1999 to supplement our operations. Direct sales and marketing expenses increased from \$106,000 in the second quarter of 1999 to \$369,000 in the second quarter of 2000, representing 106% and 53% of Direct revenue for such periods, respectively. The increase in sales and

marketing costs is due to the hiring of additional sales personnel to support the State of Texas contract and EWE. Direct research and development costs decreased 10%, from \$233,000 in the second quarter of 1999 to \$208,000 in the second quarter of 2000. Direct research and development costs decreased due to the reduction in EWE application development after the product was launched.

#### *Corporate Business Unit*

Corporate general and administrative expenses increased 69%, from \$1.2 million in the second quarter of 1999 to \$2.0 million in the second quarter of 2000. Corporate general and administrative expenses increased due to the addition of corporate legal personnel and outside legal fees to address legislative and regulatory issues related to the Company's 9-1-1 SafetyNet Product and other offerings, the hiring of additional human resources staff to accommodate headcount growth in 2000, and corporate consulting costs. Corporate sales and marketing expenses increased 38%, from \$695,000 in the second quarter of 1999 to \$961,000 in the second quarter of 2000, representing 8% and 9% in total revenue for such periods, respectively. Corporate sales and marketing expenses increased due to national tradeshow costs, direct marketing costs related to 9-1-1 SafetyNet, and public relations charges. Increase is partially offset by the reallocation of certain resources from marketing-related activities to legislative and regulatory affairs activities and the reduction in headcount for general corporate product marketing. Corporate research and development of \$624,000 in the second quarter of 2000 represents labor and associated travel and consulting costs related to network architecture of our 9-1-1 SafetyNet product offering. During the second quarter of 2000, we signed our first 9-1-1 SafetyNet customer. We currently estimate that our 9-1-1 SafetyNet product will begin to generate revenue in the first half of 2001.

Net other income increased 85%, from \$116,000 in the second quarter of 1999 to \$215,000 in the second quarter of 2000, representing 1% and 2% of total revenue for such periods, respectively. Other income increased due to interest income earned from investments and the reduction in interest expense related to the repayment of certain capital leases.

The benefit for income taxes decreased from \$178,000 in the second quarter of 1999 to zero in the second quarter of 2000. We expect to incur losses in the near term related to development costs for new commercial products and future taxable income may not be sufficient to realize additional deferred tax assets that will be created by the projected net operating losses. Consequently, we presently expect our statement of operations will not reflect tax benefits for projected operating losses to be incurred during 2000.

The loss from operations of discontinued division, net of tax, for the second quarter of 1999 of \$15,000 represents the costs related to the final closeout of unassigned contracts related to our Premise Products division, which was sold in 1997, and the transition of customers to the company that acquired this division.

#### **Six Months Ended June 30, 2000 Compared to Six Months Ended June 30, 1999**

##### *Total Company*

Total revenue increased 26%, from \$15.8 million in the six months ended June 30, 1999 to \$19.9 million in the six months ended June 30, 2000. Eighty-eight percent of revenue in the six months ended June 30, 2000 was recurring. Total direct costs increased 23%, from \$11.1 million in the six months ended June 30, 1999 to \$13.7 million in the six months ended June 30, 2000, representing 70% and 69% of total revenue, respectively.

##### *ILEC Business Unit*

ILEC revenue increased 3%, from \$13.4 million in the six months ended June 30, 1999 to \$13.8 million in the six months ended June 30, 2000. The recurring portion of ILEC revenue, approximately 95%, increased 4% in the six months ended June 30, 1999 compared to the same period in 2000. ILEC revenue increased due to an increase in the number of records under management, offset by a decrease in non-recurring fees for enhanced services. ILEC direct costs increased 6%, from \$7.4 million in the six months ended June 30, 1999 to \$7.8 million in the six months ended June 30, 2000, representing 55% and 57% of ILEC revenue for such periods, respectively. Costs increased due to the hiring of additional systems operations staff and increased systems maintenance costs to accommodate growth. ILEC sales and marketing expenses decreased 13%, from \$863,000 in the six months ended June 30, 1999 to \$752,000 in the six months ended June 30, 2000, representing 6% and 5% of ILEC revenue for such periods, respectively. The decrease in sales and marketing costs is due to a reduction in product management staff in late 1999 and early 2000. ILEC research and development costs decreased 9%, from \$181,000 in the six months ended June 30, 1999 to \$164,000 in the six months ended June 30, 2000, representing 1% of ILEC revenue for both periods. ILEC research

and development costs decreased due to increased focus by the Company's software engineering staff on projects for other business units.

#### *CLEC Business Unit*

CLEC revenue increased 129%, from \$1.5 million in the six months ended June 30, 1999 to \$3.4 million in the six months ended June 30, 2000. CLEC revenue increased due to an increase in the number of records under management for new and existing customers and additional non-recurring revenue recognized on new customers signed in 2000. CLEC direct costs increased 25%, from \$880,000 in the six months ended June 30, 1999 to \$1.1 million in the six months ended June 30, 2000, representing 59% and 32% of CLEC revenue for such periods, respectively. The dollar increase in CLEC costs is due to the hiring of additional CLEC operations staff to assist with the continued growth in records under management. The percent decrease in CLEC costs is due mainly to volume efficiencies gained by the growth in records managed. CLEC sales and marketing expenses increased 58%, from \$194,000 in the six months ended June 30, 1999 to \$306,000 in the six months ended June 30, 2000, representing 13% and 9% of CLEC revenue for such periods, respectively. The increase in CLEC sales and marketing expenses is due to the hiring of additional sales and marketing personnel to accommodate the growth in the CLEC Business Unit and increased direct marketing campaign costs. CLEC research and development costs increased 178%, from \$58,000 in the six months ended June 30, 1999 to \$161,000 in the six months ended June 30, 2000, representing 4% and 5% of CLEC revenue for such periods, respectively. CLEC research and development costs increased due to the development of Local Number Portability (LNP) software applications.

#### *Wireless Business Unit*

Wireless revenue increased 103%, from \$846,000 in the six months ended June 30, 1999 to \$1.7 million in the six months ended June 30, 2000. Wireless revenue increased due to an increase in the number of records under management and one-time fees related to system capacity expansion to accommodate wireless carriers. Wireless costs increased 7%, from \$2.1 million in the six months ended June 30, 1999 to \$2.2 million in the six months ended June 30, 2000. Costs increased due to the hiring of additional systems operations staff and increased systems maintenance and telephone line costs to accommodate growth. Wireless direct cost as a percentage of Wireless revenue decreased as the increase in subscribers managed grows to cover more of the infrastructure costs. Wireless sales and marketing expenses increased 5%, from \$284,000 in the six months ended June 30, 1999 to \$299,000 in the six months ended June 30, 2000, representing 34% and 17% of Wireless revenue for such periods, respectively. The increase in Wireless sales and marketing expenses is due to the hiring of additional sales personnel in 2000. Wireless research and development costs increased 197% from \$123,000 in the six months ended June 30, 1999 to \$365,000 in the six months ended June 30, 2000, representing 15% and 21% of Wireless revenue for such periods, respectively. Wireless research and development costs increased due to the development of improvements to our general wireless database application in 2000.

#### *Direct Business Unit*

Direct revenue increased from \$100,000 in the six months ended June 30, 1999 to \$988,000 in the six months ended June 30, 2000. Direct revenue increased due to the transition of records in the State of Texas beginning in 2000 and delivery of the EWE product offering. Direct costs increased from \$762,000 in the six months ended June 30, 1999 to \$2.5 million in the six months ended June 30, 2000. Costs increased due to the additional personnel and system infrastructure needed to implement the State of Texas contract and to manage records that have been transitioned. In addition, we opened an office in Texas in late 1999 to supplement our operations. Direct sales and marketing expenses increased from \$156,000 in the six months ended June 30, 1999 to \$682,000 in the six months ended June 30, 2000, representing 156% and 69% of Direct revenue for such periods, respectively. The increase in sales and marketing costs is due to the hiring of additional sales personnel to support the State of Texas contract and our EWE product. Direct research and development costs decreased 19%, from \$486,000 in the six months ended June 30, 1999 to \$394,000 in the six months ended June 30, 2000. Direct research and development costs decreased due to the reduction in EWE application development in 2000 after the product was launched.

#### *Corporate Business Unit*

Corporate general and administrative expenses increased 48%, from \$2.4 million in the six months ended June 30, 1999 to \$3.5 million in the six months ended June 30, 2000, representing 15% and 18% of total revenue for such period, respectively. Corporate general and administrative expenses increased due to the addition of corporate legal personnel and outside legal fees to address legislative and regulatory issues, the hiring of additional human resources staff to accommodate headcount growth in 2000, including growth related to 9-1-1 SafetyNet and corporate consulting costs. Corporate sales and marketing expenses increased 18%, from \$1.2 million in the six months ended